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Analysis: G20 keeps up snail's pace of global monetary reform

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By Alan Wheatley, Global Economics Correspondent

BEIJING (Reuters) - Another month, another inconclusive meeting of G20 finance ministers: reform of the international monetary reform is proving a hard, thankless slog.

True, Thursday's seminar in the eastern city of Nanjing confirmed the consensus that changes are needed to put the world economy on a firmer financial footing, keep a closer eye on capital flows and ensure the global monetary order better reflects the clout of China and other emerging giants.

But the devil is in the detail, and, for all the ministerial proclamations of progress, the latest talks served mainly to show that French President Nicolas Sarkozy will have his work cut out to devise a reform blueprint in time for a summit in November.

France is this year's chair of the Group of 20 leading economies.

One analyst, Citi's Steven Englander, was struck by the Alice-in-Wonderland feel to Thursday's gathering.

"So there is this meeting in Nanjing where all countries but one are trying to figure out how to get rid of the dollar as the world's major reserve currency, one country is trying to keep its currency as the world's major reserve currency but have it depreciate against all the others, and one country wants its currency to become a reserve currency but doesn't want anyone to buy it without permission.

"The intended outcome is reform of the international monetary system," Englander said in a note.

The country trying to preserve its hegemony is, of course, the United States. The aspiring reserve-currency country that wants to have its cake and eat it, too, is China.

LOCKING HORNS

The tug of war between the two led to a stalemate at February's Paris G20 over whether a big current account surplus or deficit is a good indicator of an unbalanced economy. The answer might seem obvious. But China, feeling picked upon because of its hefty surplus, dug in its heels and objected.

The bone of contention in Nanjing was over the conditions for including the yuan in the Special Drawing Right (SDR), the International Monetary Fund's quasi-currency that is part reserve asset and part in-house accounting unit.

The technical aspects of the debate are arcane, but the political significance is straightforward.

Adding the yuan to the basket of four currencies that now make up the SDR would confer prestige on China but also impose responsibilities: for the step to be of practical importance and not just a symbol of China's rise, the currency would have to be freely convertible and no longer semi-pegged to the dollar.

And that, for China, is a two-step too far. Beijing wants to dismantle capital controls and free up the yuan, also known as the renminbi (RMB), on a timetable of its own choosing. So being in the SDR would be nice, but it is not a paramount objective.

"If everyone welcomes the yuan's inclusion in the SDR, we'll also be happy to see that happening a bit early. But we are not in a hurry. We are patient," Chinese central bank governor Zhou Xiaochuan said after the meeting.

CHANGE IN THE OFFING?

Privately, Western ministers and central bank governors hope that laying out the terms of entry will give ammunition to reformers such as Zhou who are locked in constant battle with conservatives over the pace of financial liberalization.

"Nothing happens immediately, but it certainly sets the stage for those inside China who want to say 'look at what the world is prepared to give us if we do a bit more reform'," Jim O'Neill, chairman of Goldman Sachs Asset Management, said.

O'Neill, who took part in the Nanjing seminar, judged that the talks had brought the yuan's inclusion in the SDR a step closer and speculated that the IMF might not wait until its next scheduled review of the SDR basket in 2015 to change its make-up.

"Obviously it isn't going to happen right now, but the consensus that the RMB should be in the SDR pretty soon suggests to me that they are going to find some way of getting round the capital convertibility criterion," he said.

After all, O'Neill and others noted, not even the German mark was fully convertible when it was included in the SDR. Where there's a political will, there's a way.

MEANING OF INDEPENDENCE

U.S. Treasury Secretary Timothy Geithner raised eyebrows in Nanjing by insisting that a country whose currency is part of the SDR should have an independent central bank.

This would appear to be erecting a new barrier to the yuan because the People's Bank of China (PBOC) is far from independent.

But Eswar Prasad from the Brookings Institution, a Washington think tank, said Geithner was not demanding legal independence. Rather, he was signaling the need for China to scrap the yuan's peg to the dollar so the PBOC can focus squarely on fighting inflation without worrying about the impact on the exchange rate.

"He was trying to make the point that currency flexibility has to be associated with a central bank that is allowed to get on with its main job of focusing on price stability," said Prasad, who was also in Nanjing.

Comments by Christian Noyer, the governor of the Bank of France, lent weight to this interpretation.

"The basic idea is that, to have the SDR truly reflect stable currencies over time, you need to be sure that each currency that is part of the basket has a monetary policy that is conducted in a credible way and an independent way," he told a news conference.

Seen in that light, the West is giving Chinese proponents of reform another card to play in their internal political battles. The independence criterion should not be insurmountable.

So does that mean there was some substance to the Nanjing talking shop and that the divergences on display mask an emerging consensus? Not quite.

"While there was agreement on general principles, when it came to specifics there was clearly a bit of dissension," said Prasad, a former IMF official who is also now a trade professor at Cornell University.

At least G20 ministers will not have to wait long to have another crack at narrowing their differences. They meet yet again in mid-April, this time in Washington.

(Additional reporting by Kevin Yao and Langi Chiang; Editing by Kim Coghill)